The Irish Economic Update

Performing well, but risks rising

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AIB
Strong growth by Irish economy over past 6 years

- Irish economy boomed from 1993 to 2007 with GDP up by over 250% – Celtic Tiger
- Very severe recession in Ireland in 2008-2009. GDP fell by 8.5% and GNP down 11%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance programme from 2010-2013
- GDP at end of 2008-09 recession was still over 25% higher than in 2001, highlighting that the economic crash came after a long period of very strong growth, unlike in other countries
- Ireland tackled its problems aggressively in the public finances, banking sector and property market. Imbalances in economy unwound – housing, debt levels, competitiveness, BoP
- Ireland focused on generating growth via its large export base as the route to recovery
- Economy grows very strongly over 2013-18 – underlying growth averages 4.5% for the period
- Domestic economy has recovered strongly, led by rebound in investment and retail spending
- Strong jobs growth. Unemployment rate fell from 16% in early 2012 to 5.3% in December 2018
- Budget deficit eliminated at a quicker than expected pace. Small surplus recorded in 2018
Economic indicators remained upbeat in 2018

Ireland Mfg and Services PMIs

Consumer Confidence (ESRI - KBC)

Retail Sales (ex-autos) - Volume, YoY, %

Modified Final Domestic Demand

Source: Thomson Datastream, Investec

Source: ESRI - KBC, Thomson Datastream

Source: Thomson Datastream

Source: CSO, (Excludes I.P. imports & Aircraft Leasing)
Economy continued to perform strongly in 2018

- Modified final domestic demand grew by 5% yoy in Q1-Q3 2018
- Mfg PMI remained high throughout 2018 – at 55.4 in November and 54.5 in December
- Services PMI also very strong in 2018 – at 57.1 in November and 56.3 in December
- Construction PMI at strong levels throughout 2018 – at 55.5 in November, 56.3 in December
- Consumer confidence remained high in 2018 but dipped in closing months on Brexit concerns
- Retail sales (ex-motor trade) rose strongly again last year, increasing by 3.9%
- Total car regs (new + used imports) steady at very high level in 2018 – surged over 2014-17
- Further strong rise in housing completions – up 28% yoy to September
- Mortgage lending up by 20% in 2018, after rising by 29% in 2017
- Continuing strong job growth – employment rose by over 3% yoy in Q1-Q3 2018
- Live Register continued its sharp decline in 2018. Jobless rate down to 5.3% in December 2018
- Budget moved into small surplus in 2018. Tax receipts up 8.3% in the year, well ahead of target
Robust jobs growth; unemployment rate falls to 5.3%  

<table>
<thead>
<tr>
<th>Year Average</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018(f)</th>
<th>2019(f)</th>
<th>2020(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unemployment Rate %</td>
<td>10.0</td>
<td>8.4</td>
<td>6.8</td>
<td>5.7</td>
<td>5.2</td>
<td>5.0</td>
</tr>
<tr>
<td>Labour Force Growth %</td>
<td>1.2</td>
<td>1.9</td>
<td>1.1</td>
<td>1.8</td>
<td>2.0</td>
<td>1.8</td>
</tr>
<tr>
<td>Employment Growth %</td>
<td>3.5</td>
<td>3.7</td>
<td>2.9</td>
<td>3.0</td>
<td>2.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Net Migration: Year to April ('000)</td>
<td>5.9</td>
<td>16.2</td>
<td>19.8</td>
<td>34.0</td>
<td>38.0</td>
<td>40.0</td>
</tr>
</tbody>
</table>

Source: CSO and AIB ERU forecasts

![Employment (YoY, %)](image1)
![Unemployment Rate (%)](image2)
Large Irish export base performing very well

- Ireland a very open economy – exports, driven by huge FDI, equate to well over 100% of GDP
- Major gains in Irish competitiveness in past decade - weakening of euro in 2014/15 helpful
- Exports have risen strongly, helped by large FDI inflows and recovery in global economy
- Weak sterling a challenge for exports to UK, but total exports still up 9% yoy in Q1-Q3 2018
# FDI and the Irish economy

## Key FDI Impacts on the Irish Economy

- Some 1,200 multinational companies
- €189bn in Exports
- 230,000 Jobs in FDI, 390,000 in total
- €7bn in Corporation Tax (67% of total)
- 33% of State’s income tax/PRSI/USC
- €13.2bn Spending on Irish services/materials
- €11.7bn in Payroll
- 67% of Business R&D expenditure

## What Attracts FDI to Ireland?

- Access to European markets
- Low corporate tax rate of 12.5%
- English speaking country
- Well educated, flexible workforce
- Common law legal system
- Stable political framework
- Long history of successful FDI
- Access to decision makers

## World Leaders Choose Ireland

- 17 of the top 20 in ICT
- 10 of the top 10 in Pharmaceuticals
- 14 of the top 15 in Medical Devices
- 8 of the top 10 Industrial Automation
- 10 of the ‘top born on the Internet’ firms
- 20 of the top 25 Financial Services firms
- UK becoming less attractive for FDI owing to Brexit

## US Tax Changes Should Not Hit FDI

- US firms have well established operations here
- Need highly skilled, multi-lingual workforce
- Firms do not move Ireland to avoid US tax
- Ireland is base to service their European markets
- Easier to operate in local rather than US time zone
- Still wide gap between US & Irish corporate tax rates
- Very strong year for FDI in 2018
Many top global companies have big operations in Ireland
Strong recovery by domestic economy in place since 2013

- Domestic economy contracted by 20% in period from 2008-2012, with particularly big fall in construction
- Construction sees strong recovery since 2013. Output up by 15% in 2016 & 2017 and 17% in Q1-Q3 2018
- Difficult year for agricultural sector in 2018, but comes after very strong growth in 2014-17 period
- Modified final domestic demand up 5% yoy in Q1-Q3 2018, after averaging growth of 4.4% in 2014-17
- Core business investment (ex aircraft/intangibles) has rebounded since 2013. Rose by 18.5% in Q1-Q3 2018
- Consumer spending grew by close to 3% on average over 2014-2017 period. Up 3% yoy in Q1-Q3 2018
- Core retail sales rose by a strong 3.9% in 2018
- Total car regs (new + used imports) remained at very high level in 2018, having surged over 2014-17 period
High house price inflation slowed during 2018

- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013.
- House prices have since rebounded as big housing shortage emerged after 90% fall in house building.
- Little stock for sale, house building still at low level.
- Prices up 83% by November from low in March 2013 – Dublin prices up by 96%, non-Dublin rise 78%.
- House prices nationally still 18% below 2007 peak.
- House price inflation moderated last year as Central Bank lending rules and affordability impacted.
- Prices up 7% yoy nationally in November 2018, down from their peak of 13.3% in April.
- Dublin up 5% vs their peak of 13% in April, while non-Dublin slows from 15.4% in June to 9.3% yoy.
- Rents have also rebounded strongly – now over 26% above previous peak reached in 2008 per CSO data.
House building rising slowly from very low levels

- Housing completions increased by 45% to 14,500 in 2017. Expected to have surpassed 18,000 in 2018
- Housing commencements rose by 33% in 2017 to 17,500. Could have risen to near 23,000 in 2018
- Very big jump in planning permissions in 2018. Up 70% year-on-year in Q3
- Housing output still running well below annual new housing demand, estimated at circa 35,000 units
- Measures put in place to boost new house building. More Local Authority and NAMA building
- Mortgage lending up by 20% in 2018, though rise in mortgage approvals slowed
- Housing affordability hit by rising house prices, especially Dublin, but helped by low mortgage rates
- Could be 2022 before housing output rises to 35,000 units – around level of estimated annual demand
### AIB Model of Estimated Housing Demand

- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2020 – note long-term trend is upwards, adding to demand
- Pent-up demand has also built up in recent years from lack of supply
- Thus, forecast table may be under-estimating actual real level of housing demand
- Shortfall in supply met from run down of vacant stock and demand being reduced by fall in headship rate. Both factors very evident in 2011-16 and most likely in 2016-20

#### Calendar Year

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Household Formation</td>
<td>26,500</td>
<td>26,500</td>
<td>26,500</td>
<td>27,500</td>
<td>27,500</td>
</tr>
<tr>
<td>of which</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Indigenous Population Growth</td>
<td>18,000</td>
<td>18,500</td>
<td>17,500</td>
<td>16,500</td>
<td>14,500</td>
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<tr>
<td>Migration Flows</td>
<td>8,500</td>
<td>9,500</td>
<td>12,000</td>
<td>13,000</td>
<td>13,000</td>
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<tr>
<td>Headship Change*</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Second Homes</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td>Replacement of Obsolete Units</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
<td>5,000</td>
</tr>
<tr>
<td>Estimated Demand</td>
<td>32,000</td>
<td>33,500</td>
<td>35,000</td>
<td>35,000</td>
<td>33,000</td>
</tr>
<tr>
<td>Completions</td>
<td>9,900</td>
<td>14,500</td>
<td>18,500</td>
<td>23,000</td>
<td>27,000</td>
</tr>
<tr>
<td>Shortfall in Supply</td>
<td>-22,100</td>
<td>-19,000</td>
<td>-16,500</td>
<td>-12,000</td>
<td>-6,000</td>
</tr>
</tbody>
</table>

*Headship is % of population that are heads of households. Sources: CSO, DoECLG, AIB ERU
Govt debt ratios fall, private sector deleverages

**Government Debt Ratios (%)**
- General Gov Gross Debt/GDP Ratio
- Gen Gov Net Debt /Modified Gross National Income Ratio

**Gov Debt Interest (% GDP)**

**Irish Private Sector Credit (Inc Securitisations) as % GDP**

**Irish Household Debt Ratio**
- (% of Disposable Income)

Sources: Dept of Finance, CSO, AIB ERU (Note Inflated/Distorted GDP figures from 2015)

Sources: Central Bank, CSO, AIB ERU Calculations (Note Inflated/Distorted GDP figures for 2015-17)

Source: CSO, Central Bank, AIB ERU
Budget returns to surplus in 2018

- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit has fallen sharply over past decade. Fell to 0.2% of GDP in 2017
- A small surplus was recorded in 2018, estimated at 0.1% of GDP
- Primary budget surplus (i.e. excluding debt interest) of 1.5% of GDP in 2018
- Debt interest costs low – at 1.5% of GDP
- Government aims to maintain the budget in surplus in coming years
- Gross Gov Debt/GDP ratio has fallen sharply
- Irish bonds yields at very low levels
- Sovereign debt ratings upgraded; S&P have Ireland at A+, Fitch at A+, Moody’s A2
Brexit expected to lower growth rate of Irish economy

**Impact of Brexit on Output** (% deviation from base)

- ESRI estimate that Irish output would be reduced over time by 2-2.5% on a soft Brexit
- Sharp fall-off in trade with UK likely on a no-deal, hard Brexit
- Output almost 4.0% lower over time if there is hard Brexit and a fall back on WTO rules and tariffs
- Employment 2% lower and unemployment rate nearly 2% higher in hard Brexit

- Copenhagen Economics Report considers costs of regulatory divergence for goods and services and of border checks, as well as tariffs in assessing impact of Brexit
- Estimates impact by 2030 is to reduce Irish GDP by 2.8% under a soft Brexit (EEA), 4.3% in a FTA and 7% in a no-deal, hard Brexit WTO scenario
Main EU tariffs relate to food products, keeping prices up. UK may not maintain these post Brexit

Food and Beverages account for 25% of total Irish exports to UK

Around 40% of Irish food exports go to the UK

Other sectors very dependent on UK market include machinery and transport, metal products, textiles

Some 40% of indigenous Irish exports go to UK compared to 10% for foreign owned companies
AIB Brexit Sentiment Index – Q3 2018

- A total of 700 SME’s (with up to 250 employees) across the island of Ireland

- Very negative sentiment readings, but firms say Brexit is having little impact on businesses now

- SMEs surveyed are most concerned about its impact in the future, both on their own business and wider economy, as well as lack of clarity on Brexit

- Tourism, Manufacturing, Retail sectors most worried
Still much uncertainty about Brexit

- UK plans to leave EU, Single Market & Customs Union on 29 March 2019. A no deal hard Brexit the default exit mechanism if no other option agreed, unless Article 50 is extended or revoked.

- The Withdrawal Agreement reached between UK and EU allows for orderly UK departure from EU – includes transition period. However, it was voted down by the UK Parliament in January.

- The WA provides for a backstop to be triggered if agreement cannot be reached on an EU-UK trade deal that would avoid a hard border in Ireland after the transition period expires.

- The backstop is attracting strong opposition in Parliament as it could lock UK into a permanent common Customs territory with the EU. UK looking to re-negotiate the backstop.

- UK Parliament wants to avoid the default no-deal hard Brexit, but likely in the end to face a choice between it and the Withdrawal Agreement as EU ruling out any changes.

- UK likely to seek and get an extension to Article 50 to avoid a hard Brexit at end March, if it cannot get changes to the backstop in coming weeks.

- Thus, still a lot of uncertainty about Brexit, when it will occur, and what form it takes.
Irish growth to remain strong if external risks avoided

- Strong growth by Irish economy should continue
- Construction picking up from still low output levels
- Public spending on the rise
- Activity supported by low interest rate environment
- Continuing FDI despite concerns on corporate tax
- Low Irish inflation still low, well below that of the Eurozone, UK and US
- However, Brexit is a challenge for the economy
- Important also that global economy holds up given importance of exports to Ireland
- GDP growth forecast at 4.0%+ for 2019 and circa 3.5% in 2020, assuming a no-deal, hard Brexit is avoided and the global economy holds up
- ESRI estimates medium-term growth rate of economy at around 3.25% in the period 2020-2025
### AIB Irish Economic Forecasts

<table>
<thead>
<tr>
<th>% change in real terms unless stated</th>
<th>2016</th>
<th>2017</th>
<th>2018 (f)</th>
<th>2019 (f)</th>
<th>2020 (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>5.0</td>
<td>7.2</td>
<td>7.0</td>
<td>4.0</td>
<td>3.5</td>
</tr>
<tr>
<td>GNP</td>
<td>11.5</td>
<td>4.4</td>
<td>7.0</td>
<td>3.7</td>
<td>3.2</td>
</tr>
<tr>
<td>Personal Consumption</td>
<td>4.0</td>
<td>1.6</td>
<td>3.0</td>
<td>2.5</td>
<td>2.5</td>
</tr>
<tr>
<td>Government Spending</td>
<td>3.5</td>
<td>3.9</td>
<td>4.8</td>
<td>3.0</td>
<td>3.0</td>
</tr>
<tr>
<td>Fixed Investment</td>
<td>51.7</td>
<td>-31.0</td>
<td>3.0</td>
<td>7.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Modified Final Domestic Demand*</td>
<td>5.6</td>
<td>3.2</td>
<td>5.0</td>
<td>4.0</td>
<td>3.8</td>
</tr>
<tr>
<td>Exports</td>
<td>4.4</td>
<td>7.8</td>
<td>8.0</td>
<td>4.5</td>
<td>4.3</td>
</tr>
<tr>
<td>Imports</td>
<td>18.5</td>
<td>-9.4</td>
<td>4.0</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>HICP Inflation (%)</td>
<td>-0.2</td>
<td>0.3</td>
<td>0.7</td>
<td>1.0</td>
<td>1.5</td>
</tr>
<tr>
<td>Unemployment Rate (%)</td>
<td>8.4</td>
<td>6.8</td>
<td>5.7</td>
<td>5.2</td>
<td>5.0</td>
</tr>
<tr>
<td>Budget Balance (% GDP)</td>
<td>-0.5</td>
<td>-0.2</td>
<td>0.1</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>Gross General Gov Debt (% GDP)</td>
<td>72.8</td>
<td>68.0</td>
<td>64.0</td>
<td>61.0</td>
<td>56.5</td>
</tr>
</tbody>
</table>

*Excludes investment in aircraft and intangibles

Source: CSO, AIB ERU Forecasts
Risks to the Irish economy

- Main risks to Irish recovery no longer internal but external, in particular Brexit
- Brexit major issue for Ireland given its strong trading links with UK and sharp fall by sterling
- Uncertain external environment with growing downside risks to global growth from increasing protectionism/tariffs, tightening monetary conditions, problems in some emerging economies
- Questions around Irish corporation tax regime (Apple ruling, moves on tax harmonisation in EU, cuts in US/UK rates) could impact FDI. Note that Ireland has the right to set its own tax rates
- Supply constraints in new house building activity, which is recovering at a slow pace with output still at very low levels
- Competitiveness issues - high Dublin house prices, high rents, high personal taxes, rising wages
- Credit constraints – tightening of lending rules, on-going deleveraging

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